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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1965.

No. 711

JOHN NICHOLAS, Trustee of the Estate of BEACHCOMBER MOTEL, INC., Bankrupt,

vs.

UNITED STATES OF AMERICA.

BRIEF

On Behalf of Jerome Kalishman, Trustee in Bankruptcy of Seymour Wallas and Company, Bankrupt, Respondent in Cause No. 711, October Term, 1965, as Amicus Curiae.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1965.

No. 650.

JOHN NICHOLAS, Trustee of the Estate of BEACHCOMBER MOTEL, INC., Bankrupt,

vs.

UNITED STATES OF AMERICA.

BRIEF

On Behalf of Jerome Kalishman, Trustee in Bankruptcy of Seymour Wallas and Company, Bankrupt, Respondent in Cause No. 711, October Term, 1965, as Amicus Curiae.

I.

INTEREST OF JEROME KALISHMAN, TRUSTEE IN BANKRUPTCY OF SEYMOUR WALLAS AND COMPANY, BANKRUPT.

Pursuant to the order of this Court of January 17, 1966, extending an invitation to the undersigned as respondent in the case of United States v. Kalishman, Trustee in

Bankruptcy, etc., No. 711, October Term, 1965, to submit a brief in this proceeding, as amicus curiae, the undersigned herewith submits this brief in support of John Nicholas, Trustee, etc., in Cause No. 650, October Term, 1965. We agree that the issues in both cases are identical.

II.

THE QUESTION PRESENTED.

The question at issue is whether the United States is entitled to recover from the assets of the bankrupt estate as part of a cost-of-administration claim, interest on a claim for unpaid withholding taxes incurred in a proceeding instituted under Chapter XI of the Bankruptcy Act by a debtor retained in possession.

The Eighth Circuit Court of Appeals decided the issue in favor of the undersigned in the case of **United States of America v. Jerome Kalishman, Trustee,** 346 Fed. (2d) 514.

III.

STATEMENT OF THE CASE.

In the Nicholas case, and in the Kalishman case also, debtor corporations filed petitions instituting proceedings under Chapter XI of the Bankruptcy Act. In each proceeding orders were made continuing the debtor in possession. The debtor in possession in each case operated its business and incurred liabilities for taxes after the petition was filed. The obligations to the United States for such taxes were not paid when due. This gave rise to a claim on behalf of the Government for interest during the period that the claims remained unpaid. Question has arisen as to whether the Government is entitled to interest. In each case the proceeding for an arrangement under Chapter XI failed, resulting in a subsequent adjudication in bankruptcy, and any burden resulting from the payment of interest will ultimately fall upon the general creditors of the bankrupt rather than upon the debtor or any successor of the debtor.

IV.

ARGUMENT.

A.

Where a Chapter proceeding in bankruptcy is superseded by an adjudication, all costs of administration including taxes incurred during the operations of the debtor-in-possession are on a parity.

We respectfully submit that the learned Judges of the Fifth Circuit Court in deciding the Nicholas case overlooked or did not give effect to the rule that where Chapter proceedings in bankruptcy are superseded by an adjudication, all costs-of-administration, including costs incurred during the operations of the debtor in possession, are on a parity. The Government does not have in such a case the priorities that it has under Section 64a of the Bankruptcy Act (11 U. S. C. § 104a). Throughout these two cases the Government has taken the position that the trustee should have paid forthwith the tax claims resulting from the operations of the debtor in possession without first ascertaining whether or not ultimately there would be sufficient funds to pay other costs-of-administration claims. Congress has not seen fit to extend to tax claims incurred during operations in a Chapter XI proceeding the same priority which the Government has in straight bankruptcy and in other insolvency proceedings.

Under the authorities it is clear that where a Chapter proceeding under the Bankruptcy Act is superseded by liquidation, all obligations including tax obligations incurred during the operation in the Chapter proceeding are on a parity as costs of administration.

State of Missouri v. Earhart (C. C. A. 8), 111 F. (2d) 992, cert. den. 311 U. S. 676, 85 L. Ed. 435, 61 S. Ct. 43;

In re Columbia Ribbon Co. (C. C. A. 3), 117 F. (2d) 999, 1001;

In re Lambertsville Rubber Co. (C. C. A. 3), 111 F. (2d) 45.

In the Earhart case the Court emphasized (111 F. (2d) at p. 995) that where a straight bankruptcy liquidation follows a Chapter proceeding the claim of a sovereign has no priority over other cost of administration claims, that on the question of priorities the provisions of the Bankruptcy Act govern.

The danger of a premature payment of a tax claim is ably discussed by Judge Biggs in the Lambertsville case.

See also:

In re West Coast Cabinet Works (D. C. Calif.), 92 F. Supp. 636, footnote p. 659.

B.

In bankruptcy, claims for priority are strictly construed, and usually the prompt payment of the principal amount of the government's claim is impossible.

Section 354 of the Bankruptcy Act (11 U. S. C., § 754) covers the filing of claims due and owing at the time of the filing of the original petition. There is no provision in the Act for the filing of cost of administration claims and no time limitation compelling the filing by any particular date. Neither is there any provision in the Bankruptcy Act requiring that the debtor-in-possession or any other party file a schedule or list of cost-of-administration claims, so the Referee and the trustee are totally in the dark until the close of the administration as to what obligations have been incurred. The usual procedure is for a trustee to apply for and cause to be published a "bar order", fixing a final date for the presentation of claims incurred while the debtor-in-possession was operat-

ing, but as a matter of fairness and equity a trustee should not attempt to bar the presentation of such claims until the estate is ready to be closed.

The point we make is, that until an estate is ready for closing neither the Bankruptcy Court nor the trustee of such an estate as this can possibly know whether there are sufficient funds on hand to pay, first, the expenses of the bankruptcy administration, and secondly, the cost-of-administration claims. Even at best some guessing has to be done if costs of administration are to be paid before the expenses of administration have been determined, for the claims of receivers, attorneys for the receivers, trustees, and attorneys for the trustees are all determined after notice to creditors at the final meeting. Then and not until then can an order of distribution be made.

It so happens that on occasions operations by a debtor-in-possession are unfortunately unsuccessful. If the trustee has paid any one or more of the cost-of-administration claims in full, and then it turns out that there are insufficient funds to pay all of such claims in full, some of such creditors have been treated unfairly and the trustee will be liable on his bond.

The decision in this Court in the case of **King v. United States**, 379 U. S. 329, 85 S. Ct. 427, 13 L. ed. 2d 315, has a bearing on the issues here before the Court. In the King case the Supreme Court held that a distributing agent in a Chapter XI proceeding was liable for failing to pay a claim of the United States in full. The United States was placed in jeopardy because other creditors having a lower priority were paid by the distributing agent. The liability fixed upon the distributing agent was a personal liability placed upon him.

We offer these comments. In the King case the distributing agent was held liable for paying second priority

claims ahead of first priority claims, and Justice White in a concurring opinion gave some weight to the fact that the distributing agent had knowledge of all the facts.

Thus it was held that one in a fiduciary capacity in a bankruptcy proceeding who pays second priority claims without ascertaining and paying first priority claims first, is liable. It is to avoid such a liability that a trustee in bankruptcy must necessarily withhold paying the government's claim until he can ascertain what the amount of the first priority claims are.

There is another important distinction. The court in the King case placed emphasis upon the fact that the distributing agent had sole control of the funds. That was not true in the case at bar, because where there has been an adjudication in bankruptcy the Referee's signature to checks is required. In the King case this does not appear to have been true. Under General Order in Bankruptcy No. 29 checks of a trustee must be countersigned by the judge or by a referee or by a clerk under an order made by the judge.

In that connection also we refer with emphasis to Section 39a (5) of the Bankruptcy Act (11 U. S. C., § 67a (5)), wherein it is provided that it is the duty of the Referee to declare dividends and cause to be prepared dividend sheets showing the dividends declared and to whom payable. Thus it will be seen that under the law the administration of funds in a straight bankrupty proceeding is under the control of the Court.

We cannot with assurance comment upon the situation in the Nicholas case, but we know that in the Kalishman case the Referee in Bankruptcy could not have permitted payment to be made to the United States because the Referee had no way of knowing, nor could the trustee have assured him, that there would be sufficient money in the estate to pay all other cost-of-administration claims

in full. The aggregate amount of cost-of-administration claims could not be determined until the estate was ready for closing.

The position of the Government is that it is the duty of the trustee to pay the tax claim in full at once even though there may not be enough funds on hand to pay other claims which are on a parity with the Government's claim.

If the United States was entitled to immediate payment of its cost of administration claim, all other holders of cost of administration claims, being on a parity, were likewise entitled to be paid at the same time, and what is a trustee to do, at the outset of his administration, before he has liquidated the assets of his estate, when he has no money in the bank?

The Government contends that under such circumstances the estate must pay interest. This must come out of the pockets of general creditors. We say that this attitude is unconscionable, and that the Bankruptcy Court as a court of equity should not sanction and enforce such a theory. The Government is seeking a priority to which it is not entitled even if it could be ascertained beyond doubt that the funds in the trustee's are sufficient to pay all cost-of-administration claims in full, because it demands to be paid before the Court is prepared to order payment of other claims on a parity with the Government's claim. This would be giving the United States a priority in time of payment not authorized by law.

The law does not sanction such a result.

An essential purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate and that no claimant is to be preferred over others unless the Bankruptcy Act by its terms requires such a result; and there is a rule that a priority of a claim against the

bankrupt for taxes due is to be strictly construed and that the burden of establisihng a priority is upon the claimant.

> Standard Oil Company v. Kurtz (C. C. A. 8), 330 F. (2d)178.

Priorities in bankruptcy are determined by the provisions of the Bankruptcy Act, and for the United States to establish a priority it must look to the provisions of that Act in order to establish it.

> Davis v. Pringle, 268 U. S. 315, 69 L. Ed. 974, 45 S. Ct. 549.

The Government argues the liability to pay tax incurred as a cost of administration is imposed upon the trustee in bankruptcy upon adjudication rather than upon the debtor-in-possession, but the liability upon the trustee is merely to recognize such a tax as a cost of administration, and if the funds are not sufficient, to pay the taxing authority its pro-rata share, and then only on order of court.

The Government completely ignores the 1952 amendment to Section 64a (1) of the Bankruptcy Act (11 U. S. C. § 104a (1)) which provides:

> "Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration * * *."

This points up the impossibility in many cases of paying expenses of administration claims under Chapter XI until the court is reasonably certain that there will be sufficient funds to pay priority expenses first, and then cost-of-administration claims in full.

C.

It is inequitable for a bankruptcy court to allow post-bankruptcy interest on tax claims where the burden of the payment would fall upon other creditors.

City of New York v. Saper, 336 U. S. 328, 93 L. Ed. 710, 69 S. Ct. 554, established new law. Prior to the Saper case it was generally held that the United States was entitled to interest on its tax claim until payment was made or until the claim was barred by limitations. This was conceded in the opinion (336 U. S. at p. 333, 93 L. Ed. at p. 716). The real basis for the decision in the Saper case was, that it was inequitable to allow the Government interest on funds while those funds were in custodia legis. The court pointed out that to allow the Government interest on its claim would give the Government preferred treatment over other claimants and that there was nothing in the law which justified the conclusion that Congress intended to give the Government preferred treatment.

We recognize the fact that the Saper case involved post-bankruptcy interest on a claim which arose prior to bankruptcy. Other cases which we shall cite are similar in that respect. But the fundamental reasoning behind these cases applies to the case at bar. The philosophy of the Saper case is just as applicable here as to those cases which involve interest on claims existing at the time of bankruptcy.

The Saper case was followed in short order by **United States v. Edens,** 342 U. S. 912, 96 L. Ed. 682, 72 S. Ct. 357, and by **United States v. General Engineering & Manufacturing Co.,** 342 U. S. 912, 96 L. Ed. 682, 72 S. Ct. 358. In General Engineering the court was considering the allowance of a tax claim in a Chapter XI proceeding, and as in the Saper case, the claim arose prior to bankruptcy. The court held there should be no distinction between

ordinary bankruptcy and Chapter XI cases and cited in support of its conclusion Section 302 of the Bankruptcy Act (11 U. S. C., § 702), which provides that the provisions of Chapters I to VII of the Bankruptcy Act should apply to Chapter XI proceedings insofar as those provisions are not inconsistent with the provisions of Chapter XI.

From the plethora of litigation which continued to arise after the Saper case, apparently the Government was not satisfied with that decision. We shall not attempt to refer to all of the cases, but we shall cite some of them which evidence the philosophy of the courts and the reasoning behind the decisions.

State of New York v. Feinberg (C. C. A. 2), 204 F. (2d) 502, was a Chapter X proceeding in which the State of New York objected to a plan of reorganization that provided for the issuance of debenture bonds upon the State's claim for taxes to bear interest at the rate of only six percent per annum instead of a higher rate provided for by New York Law. The decision seems to hold that since the State of New York was not under the law entitled to interest at all after bankruptcy, it could not complain at the rate at which the rate of interest was revived.

The Sixth Circuit Court of Appeals in the case of **In re Inland Gas Corporation,** 241 F. (2d) 374, points out that so far as interest is concerned debts due for taxes are on a par with other debts of the bankrupt, and citing the Vanstone Bondholders case, to which we shall refer later, it was held that the court should consider and balance the equities between the parties.

In re Huff Co., 96 F. Supp. 701 (D. C., Mich.), is an important District Court decision in which the court held that in determining the right of the United States to interest the rule disallowing post-bankruptcy interest is an equitable one, not only in bankruptcy cases aimed at liqui-

dation but those involving Arrangements, and that the rule of the Saper case is one based upon equitable principles.

The Fourth Circuit Court of Appeals in **United States v. Harrington,** 269 F. (2d) 719, declares that the rule against post-bankruptcy interest upon tax claims is designed to prevent other creditors from suffering by the allowance of post-bankruptcy interest.

In a Fourth Circuit Court case decided prior to the Saper decision, **Littleton v. Kincaid,** 179 F. (2d) 848, the court held that interest should not be paid out of fund in custodia legis because of the inequality that would result. In the more recent Ninth Circuit case of **Beecher v. Leavenworth State Bank,** 192 F. (2d) 10, a farmer debtor proceeding, the reasoning of the court is along the same lines.

In **Columbia Aircraft Company v. United States,** 163 F. Supp. 932, Judge Learned Hand in a District Court decision held that the doctrine of the Saper case was applicable in an Arrangement case to the claim of the Government to set off its claim for interest against the debtor's claim for over-payment of taxes.

Another line of cases involves the Government's claim that where a tax lien had been perfected prior to bankruptcy, the doctrine of the Saper case is inapplicable. The courts have uniformly rejected this contention.

Simonson v. Granquist, 369 U. S. 38, 7 L. Ed. (2d) 557, 82 S. Ct. 537;

In re Cameron (D. C. Calif.), 166 F. Supp. 400, aff'd. 271 F. (2d) 129;

In re Young (D. C. Wisc.), 171 F. Supp. 317;

In re Kerber Packing Company (C. C. A. 7), 276 F. (2d) 245;

In re Industrial Machine & Supply Co. (D. C. Pa.), 112 F. Supp. 261.

In the Industrial Machine & Supply Co. case the court points out, as other decisions have done, that interest should not be allowed against funds held by an officer of the court since delay in distribution is an act of law and is a necessary incident in the administration of the estate.

There is some analogy between the situation before the Court and that which faced the courts in determining whether bondholders holding obligations which provided for interest, were entitled to have that interest run after bankruptcy, in accordance with the provisions of the bonds. Of course this question is well settled now, but at the outset the problem reached the Supreme Court of the United States, and it was held that a Bankruptcy Court as a court of equity had the power to determine how a debtor's assets should be distributed and that a court of bankruptcy sitting as a court of equity would not enforce the contractual obligation which provided for the running of interest.

Vanston Bondholders Protect. Com. v. Green, 329 U. S. 156, 91 L. Ed. 162, 67 S. Ct. 237.

The Government contended in its brief filed below* "that interest constitutes an integral part of a tax liability," and that taxes and resulting interest constitute a single liability. That may be true in some cases, but it is not an inexorable rule. There is responsible authority to the effect that penalties and interest are not taxes.

United States v. Mighell (C. C. A. 10), 273 F. (2d) 682;

United States v. Nelson (D. C. Ill.), 91 F. Supp. 557;

Penrose v. United States (D. C. Pa.), 18 F. Supp. 413;

Capital Bldg. & L. Asso. v. Commissioner, 23 B. T. A. 848.

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* Throughout this brief we are compelled to assume that the Government will in the main rely upon the authorities cited in its Eighth Circuit brief.

The Supreme Court in the Saper case did not recognize any such rule, nor is any such rule recognized in the many cases following the Saper case, such as

United States v. Harrington (C. C. A. 4), 269 F. (2d) 719;

In re Kerber Packing Company (C. C. A. 7), 276 F. (2d) 245.

A number of non-bankruptcy cases state that a penalty for non-payment of a tax is merged in the tax so that the two become a single liability, but that is not a rule in bankruptcy cases.

Bankruptcy Act, Sec. 57j, 11 U. S. C., § 93j;

In re Tom's Villa Rosa, Inc. (D. C. Conn.), 198 F. Supp. 137.

The real point we are dealing with here is whether there is any equitable ground for an exception to the general rule that post-bankruptcy interest is not allowable or payable out of the assets of the bankrupt estate.

D.

In determining whether interest on tax claims is allowable in bankruptcy proceedings, the provisions of the Bankruptcy Act rather than of the Internal Revenue Code govern.

The United States in support of its position has cited statutory provisions contained in 28 U. S. C., § 960, contending that they govern. It must be remembered that at the time of the Saper case there was in effect Section 3466 of the Revised Code of the United States, Comp. Stat., § 6372,* which gave the United States priority of the payment of tax claims in insolvency cases. It has been uniformly held that such a general provision of the Federal Law does not apply in bankruptcy, that to determine the

* See Appendix I.

rights of the parties including tax claimants we must look solely to the provisions of the Bankruptcy Act. In fact, that is the philosophy of the Saper case.

We note that 28 U. S. C. A., § 960, refers to "any officers and agents conducting any business under authority of a United States Court." We are also cognizant of the fact that there are decisions holding that the status of a debtor-in-possession is that of a trustee. But their positions are not exactly similar and should certainly appear dissimilar to a court of equity. Here the trustee did not operate a business. A trustee or a receiver operates under a bond, and is liable for his mistakes. A debtor-in-possession does not so operate, and his mistakes under appellant's theory would fall upon innocent parties.

The Saper case was decided as it was in spite of the provisions of the Internal Revenue Code of 1939 which governed the liability for taxes and provided that in case of delinquency the interest should be added as part of the tax (1939 Internal Revenue Code, §§ 3670, 3671).**

To consider further 28 U. S. C. A., § 960, we refer to a discussion of that section contained in **McColgan v. Maier Brewing Company** (C. C. A. 9), 134 F. (2d) 385. The decision points out that prior to the enactment of this section the law on the subject of the liability of court officers was in a choatic condition, and that this provision in the statute was not in terms or by implication intended to impair the principle that property in the custody of the Bankruptcy Court may not be subjected to liens while so held.

We submit that the purpose of the enactment of 28 U. S. C. A., § 124a, now designated as 28 U. S. C., § 960, was to fix the liability of officers of the court engaged in business, to require them to pay taxes as expenses of their operations or to assume a risk in the event of their failure

** See Appendices II and III.

so to do. The purpose of this enactment was not to penalize other creditors in the event of the failure of officers to perform their duties.

The holding in a New York District Court case, **In re Ten Eyck Co., Inc.**, 40 F. Supp. 270 stated:

> "Certainly it cannot be held that section 124a of Title 28 was intended to amend the Bankruptcy Act in any way or to prevail over it."

We have heretofore cited **State of Missouri v. Earhart** (C. C. A. 8), 111 F. (2d) 992,* which held that the court in classifying expenses of administration would be bound by the provisions of the Bankruptcy Act and not by the provisions of the Internal Revenue Code.

We have also referred to the case of **Davis v. Pringle**, 268 U. S. 315, 69 L. Ed. 974, 45 S. Ct. 549, decided some years prior to the Earhart case, a case in which the Government claimed that by reason of Section 3466 of the Revised Statutes, the United States had priority under Section 64a (5) over other creditors. At that time 64a (5) gave a fifth priority to:

> "Debts owing to any person who by the laws of the State or the United States is entitled to priority."

And it was argued that this section gave priority to the United States because of said Section 3466. It is extremely significant that this claim on the part of the Government was denied. (Since that time Section 64a (5) has been amended so as to include specifically the United States.) Justice Holmes in Davis v. Pringle based his finding upon **Guarantee Title & T. Co. v. Title Guaranty & S. Co.**, 224 U. S. 152, 56 L. Ed. 706, 32 S. Ct. 457, in which the court rejected the Government's claim that Section 3466 of the Revised Statutes established for the United States

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* Cert. den. 311 U. S. 676, 85 L. Ed. 435, 61 S. Ct. 43.

in bankruptcy proceedings a priority claimed by the United States.

We deny the contention of the United States argued below that under the decision of the lower courts the debtor-in-possession and the trustee would obtain an advantage over other businesses which is not sanctioned by Section 960 of 28 U. S. C. The Government in this case is seeking an advantage over other creditors holding cost-of-administration claims, because those creditors not only do not get interest on their claims, and, as we have pointed out, it is conceivable that the premature payment in full of the Government's claim would deprive other cost of administration creditors of money to which they are entitled; or if the Government's claim is not paid promptly, and interest is paid on it, this would give the Government interest where interest is not paid on other cost of administration claims.

The Government in its brief in the Eighth Circuit cited many cases of general application, interesting in themselves, but which do not touch upon the point at issue here. Some of them are non-bankruptcy cases. Most of them were decided prior to the Saper case, which in effect reversed holdings in many prior cases. Cited were such cases as **United States v. Killoren**, 119 F. (2d) 364, the rule of which was nullified by subsequent legislation. The Government also cited **Michigan v. Michigan Trust Company**, 286 U. S. 334, 76 L. Ed. 1136, 52 S. Ct. 512. This is not a bankruptcy case and all that it holds is that franchise taxes imposed by Michigan Statute must be paid as a cost of administration by an operating receiver incurring such taxes, that a claim for such taxes has priority over the claims of general creditors. We shall attempt to discuss only those cases which appear to have a direct bearing upon the problem here before this Court.

Boteler v. Ingels, 308 U. S. 57, 84 L. Ed. 78, 60 S. Ct. 29, involved a claim of the United States for a penalty im-

posed by state law for failure to pay license fees accruing during the operation of the bankrupt's business by a trustee in bankruptcy. The court held that since the penalty arose after the filing of the petition, Section 57j of the Bankruptcy Act (11 U. S. C., § 93j) had no application and that the state was not barred from collecting the penalty. The Boteler case was decided ten years before the Saper case and the court did not discuss the equities of the situation. **In re Chicago & N. W. Ry. Co.** (C. C. A. 7), 119 F. (2d) 971, decided in 1941, and **In re Flayton** (D. C. N. Y.), 42 F. Supp. 1002, decided in 1942, involving penalties, and **In re International Power Securities Corp.** (D. C. N. J.), 109 F. Supp. 544, decided in 1953, involving interest, followed the Boteler case. It does not appear to us that in any one of these cases the amount of the liability fell upon innocent creditors, and in none of them did the court discuss the equities of the situation. The Saper case was decided in 1949.

The Government also relied upon **Bruning v. United States**, 376 U. S. 358, 11 L. Ed. (2d) 772, 84 S. Ct. 906. The Bruning case did not involve the liability of the estate but of a debtor for post-petition interest. It was not concerned with payment out of the funds of an estate, and in its decision the Court stated:

> "The basic reasons for the rule denying post-petition interest as a claim against the bankruptcy estate are the avoidance of unfairness as between competing creditors and the avoidance of administrative inconvenience."

The Government in discussing the Bruning case assumed that the language quoted above does not apply to the facts of this case. With that we disagree. Government's counsel assumed that taxes constitute a first priority and can be paid forthwith. For reasons we have stated elsewhere, taxes are not a first priority under the 1952 amendment to Section 64a (1) of the Bankruptcy

Act [11 U. S. C. 104a (1)], and in addition, must share pro-rata with other costs of administration.

And then there is **In re Airline-Arista Printing Corp.** (D. C. N. Y.), 156 F. Supp. 403.* In this Chapter XI case the debtor-in-possession was ordered to segregate amounts withheld from the wages of employees and to place these amounts in a special fund. The debtor-in-possession failed to comply with the court order. The court found (l. c. 404) that "At all times the debtor-in-possession had assets of a greater value than the amount of the taxes which it had withheld and these assets came into the hands of the trustee." The intermingling of such amounts with the general funds of the debtor-in-possession was not only wrongful under the Internal Revenue Code but contrary to the specific order of the court and the funds so withheld constituted the corpus of a trust. **The Airline-Arista case did not involve the payment of interest.** All that it held was that the Government had succeeded in tracing the corpus of a trust consisting of money withheld from the wages of employees, that therefore the Government was entitled to it, and that the provisions of the 1952 amendment to Section 64a (1) therefore did not apply.

E.

The claim of the United States for interest cannot be sustained on the theory of a trust since the Trustee in Bankruptcy acquired no trust funds.

It is not essential to the decision in this case to determine whether the principal amount of the Government's claim, i. e., its claim for the amount of the withholding taxes, were subject to a trust, whether or not the funds could be traced. But interest cannot be held subject to a trust because the interest was never in existence, and a

* Aff'd 267 F. (2d) 333.

trust cannot exist where there never was a corpus of the trust estate.

Restatement of the Law of Trusts (2d), § 202, Ch. 7, p. 451;

Restatement of the Law of Restitution, § 215, Ch. 13, p. 866;

Scott on Trusts (2d ed.), Vol. IV, p. 3325, § 52;

Bogert, "Trusts and Trustees" (2d ed.), § 921, Ch. 44, pp. 303-305.

For a cestui to recover from a fund on hand, he must trace into that fund:

Macey v. Roedenbeck (C. C. A. 8), 227 Fed. 346;

Mechanics & Metals Nat. Bank v. Buchanan (C. C. A. 8), 12 F. (2d) 891;

Farmers' Nat. Bank v. Pribble (C. C. A. 8), 15 F. (2d) 175;

Dudley v. Richards (C. C. A. 8), 18 F. (2d) 876;

Hanna v. Consolidated School Dist. No. 1 (C. C. A. 8), 78 F. (2d) 374.

The above decisions are in conformity with decisions of the Supreme Court. Mr. Justice Cardozo in a 1935 opinion used the following language: " * * * The money so returned is then subjected to a trust and though mingled with other money is viewed as retaining its identity so long as any portion of the fund is discovered to be intact. These fictions and presumptions * * * will not be so applied as to impose a trust relation upon moneys that have entered into 'the stream of the firm's general property' (cases cited) and are distinguishable no longer."

Adams v. Champion, 294 U. S. 231, 238, 79 L. Ed. 880, 884, 55 S. Ct. 399.

Two years later this Court reaffirmed the rule of Adams v. Champion, citing the following excerpt from 294 U. S., l. c. 239:

"Evidence is lacking that it (wrongful withdrawal) was withdrawn in such a form or for such purposes as to be represented by any assets forming part of the estate today."

Hoffman v. Rauch, 300 U. S. 255, 258, 81 L. Ed. 629, 631, 57 S. Ct. 446.

It is an abuse of language to describe an obligation, no matter how important it may be, as a trust obligation where there is no trust. The fact that there should be a trust does not miraculously create one when there is none. Wishing cannot make it so and only leads to bad law.

F.

Section 378 of the Bankruptcy Act has no application to the situation here before the court.

The Government has contended that in a situation where an adjudication follows a Chapter XI operation by a debtor in possession, the provisions of Section 378 of the Bankruptcy Act (11 U. S. C., § 778) require that the proceedings be conducted as far as possible as if an order of adjudication had been entered on the day when the petition was originally filed. We are not convinced that under the circumstances of this case that Section 378 is applicable. It does not require that in every instance the proceedings be conducted as if there had been an adjudication on the date of filing but only that this be done "so far as possible." It is difficult to see how the court can hold that Section 378 is applicable to something that did not begin to happen until after the date of filing. Under the 1952 amendment to Section 64a (1) expenses of liquidation must first be paid, as we have heretofore shown.

But even if this were true, the reasoning and logic of the Saper case and of the other cases that we have cited seem to apply. There is no valid or logical reason why a court of equity should hold that 28 U. S. C. A., § 960 has any

greater application to an operation under the Bankruptcy Act after adjudication than Sections 3670 and 3671 of the 1939 Internal Revenue Code and Section 3466 of the Revised Statutes had to an operation prior to adjudication.

V.

CONCLUSION

The equitable considerations which impelled the Supreme Court in the Saper case to protect the interest of creditors are just as applicable to the creditors in this case as in the Saper case. If it was inequitable to take interest from funds in custodia legis for the benefit of one creditor and to the detriment of others, as the Supreme Court found it was in the Saper case, it is just as inequitable in the case here before the Court.

Respectfully submitted,

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APPENDIX I.

Section 3466 of the Revised Statutes of the United States:

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

APPENDIX II.

Section 3670 of the 1939 Revenue Act:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or additional to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

APPENDIX III.

Section 3671 of the 1939 Revenue Act:

"Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time."